

## MEMORANDUM OF LAW

DATE: November 6, 1991

TO: Larry Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Fiduciary Liability Insurance

You have requested an analysis of existing Municipal and Government Code protection for the members of the Board of Administration, City Employees' Retirement System ("Retirement Board") in each of the categories of membership, if applicable. You have noted that Retirement Board members fall into one of four categories: elected active members; elected retirees, ex-officio members who are active City employees; and private citizens appointed by the City Council. You also have indicated that it is your understanding that there may be sufficient existing protection so that there is no need for the purchase of additional fiduciary liability insurance even for those members of the Retirement Board who are private citizens.

Briefly, there is an existing statutory scheme for the indemnification of City employees. There is also existing protection for all Retirement Board members regardless of their membership category. Our analysis of scope of the Retirement Board member's duties and responsibilities and the existing Municipal and Government Code protections for them follows.

### BACKGROUND

The City Employees' Retirement System ("CERS") is authorized by and established pursuant to San Diego City Charter ("Charter") section 141 et seq. Those Charter provisions were incorporated into the current Charter at its adoption in 1931. Pursuant to the Charter, a series of detailed ordinances (San Diego Municipal Code ("SDMC") sections 24.0100 et seq.) have been enacted for the purpose of giving effect to those provisions.

Pursuant to Charter section 144, the Retirement Board was created to manage CERS. Under this section, the Retirement Board is authorized to enact and has enacted Rules of the Board of Administration to augment the retirement ordinances by providing guidance and establishing and clarifying the administrative and procedural processes necessary to carry out its responsibilities, as set forth in the Charter and Municipal Code. In addition, Section 144 provides:

to the Board of Administration shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under which persons

may be admitted to benefits of any sort under the Retirement System; and shall have exclusive control of the administration and investment of such fund or funds as may be established.

Significantly, Charter section 145 entitled "Retirement Fund" provides:

All moneys contributed by employees of the City or appropriated by the Council or received from any other source under the terms of this Article, shall be placed in a special fund in the City Treasury to be known as the City Employees' Retirement Fund, which said fund is hereby created. Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article. No payments shall be made therefrom except upon order of the Board of Administration. This fund may be placed by the Board under the Funds Commission for investment; but shall not be merged with other funds of the City. (Emphasis added.)

Generally, pension plans create both contractual and trust relationships. They create a contractual relationship between the employer and employees under which the employer contributes retirement benefits to induce continued faithful service by the employees. They also create a trust relationship between pensioners-beneficiaries and the trustees of pension funds who administer retirement benefits. The trustees must exercise their fiduciary responsibilities in good faith and must deal fairly with the pensioner-beneficiaries. *Hittle v. Santa Barbara County Employees Retirement Assn.*, 39 Cal. 3d 374, 392 (1985); *Lix v. Edwards*, 82 Cal. App. 3d 573, 578 (1978); *Hannon Engineering, Inc. v. Reim*, 126 Cal. App. 3d 415, 425 (1981).

Retirement Board members are trustees of the CERS trust funds. They are accountable for that degree of financial and official behavior as required by law. Generally, their duties are set forth in the Probate Code at section 15000 et seq. Effective July 1, 1991 this division is known and cited as the Trust law. Although "trusts for the primary purpose of paying debts, dividends, interest, salaries, wages, profits, pensions, or employee benefits of any kind" are expressly excluded from the definition of a trust under the Probate Code (Probate Code section 82(b)(13)), Probate Code section 15003(b) makes it clear that the repeal in 1986 of the Civil Code provisions relating to trusts, particularly former Civil Code sections 2215-2244 was not intended to affect general fiduciary principles. Those general fiduciary principles are now set forth at Probate Code section 16000 et seq.

Those principles include a duty of loyalty (Probate Code section 16002), a duty to deal impartially with beneficiaries (Probate Code section 16003), a duty to avoid conflict of interest (Probate Code

section 16004), a duty to take control of and preserve trust property (Probate Code section 16006), a duty to make the trust property productive (Probate Code section 16007), a duty to dispose of improper investments (Probate Code section 16008), a duty to keep trust property separate and identified (Probate Code section 16009), a duty to enforce claims (Probate Code section 16010), a duty to defend actions (Probate Code section 16011), a duty not to delegate (Probate Code section 16012) and a duty to use special skills (Probate Code section 16014).

Practically speaking, a trustee's particular duty of care incorporates the requirement of good faith. The requirement of good faith requires the trustee to act in the interest of the trust exclusively. Trustees are obliged to use the utmost care to protect trust property and make the trust productive. *Allen v. Hussey*, 101 Cal. App. 2d 457 (1950); *Cullinan v. Mercantile Trust Co.*, 80 Cal. App. 377 (1926).

The Constitution for the State of California also discusses the assets of public pensions or retirement systems and the duties of the fiduciaries managing those funds. Article XVI, section 17 provides in pertinent part:

(a) The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.

(b) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.

(c) The fiduciary of the public pension or retirement system shall discharge his or her duties with respect to the system with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(d) The fiduciary of the public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.

With respect to public officers in responsible charge of public funds, the California Supreme Court observed in *Stevens v. Geduldig*, 42 Cal. 3d

24, 32 (1986):

As this court said in *Stanson v. Mott* (1976) 17 Cal.3d 206, 213, '(w)e start with the general principle that expenditures by an administrative official are proper insofar as they are authorized, explicitly or implicitly, by legislative enactment . . . . (S)uch executive officials are not free to spend public funds for any 'public purpose' they may choose, but must utilize appropriate funds in accordance with the legislatively designated purpose.' Accordingly, a public official who controls public funds may be held personally liable to repay improperly expended funds if he has failed to exercise due care in permitting the expenditure.  
Id. at 226-227.

As opined by the City Attorney in Opinion Number 85-1, dated May 8, 1985, Retirement Board members also have a responsibility to seek and obtain a maximum degree of investment return, bearing in mind and accommodating the risk involved therein, for the sole and exclusive purpose required by the Charter. Consequently, if funds are improperly or poorly invested, ultimate responsibility lies with the Board and liability may attach jointly and severally. With respect to potential liability, the issue then becomes the scope of protection or indemnification from CERS or The City of San Diego. A summary of those protections follows:

#### EXISTING GOVERNMENT CODE PROTECTIONS

The Tort Claims Act (Government Code sections 810-895.8, 900-978.8, 989-991.2, 995-996.6, 945.5, 960-990.8, 53050-53052 and Labor Code sections 3365-3366) defines and limits the liabilities of public employees only while they are within the scope of their employment because only then are they "public employees" within the meaning of the Act. For purposes of the Act, "employee" includes an officer, employee or servant, whether or not compensated. Government Code section 810.2. A "public entity" includes "the State, the Regents of the University of California, a county, city, district, public authority, public agency, and any other political subdivision or public corporation in the State." Government Code section 811.2. A "public employee" means an employee of a public entity." Government Code section 811.4.

Retirement Board members for CERS are public employees within the meaning of the Government Code. Charter section 117(a)(2) provides that "Members of all boards and commissions" are included in the unclassified service employment category for the City of San Diego. The fact that certain Board members are elected City employees while others are private citizens appointed by the City Council is of no significance. All of the Board members are "public employees" under the Government Code

provisions cited above. As such, they are entitled to all of the protections afforded other City employees as long as they are acting in their capacity as Retirement Board members and acting within the scope of their fiduciary responsibilities.

We are advised that the City has purchased an insurance policy to cover the liability of City employees while exercising their duties and responsibilities regardless of the department they may be assigned to. The limits of insurance are in the amount of 12 million over and above the first 5 million of self insured retention by the City. Claims or litigation over the 17 million described above become the responsibility of the City.

Please be advised that any insurance policy purchased to cover the liability of City employees while exercising their duties and responsibilities in their respective departments would also cover the Board members exercising their duties and responsibilities with respect to the administration of CERS and its trust fund. As such, the Board members will be protected and indemnified by the City while serving in their capacity as Board members as long as they are acting within the scope of their responsibilities.

Subject to stated exceptions, a public entity is required on request of an employee or former employee to provide for the defense of any civil action or proceeding against that employee based on acts or omissions in the scope of that employee's public employment. Government Code section 995. This statutory duty is in addition to and does not impair any rights the employee may have under a contract or other statute. Government Code section 996.6. Moreover, these statutes of statewide concern prevail over municipal or charter ordinance provisions purporting to restrict the duties of the city attorney and City to preclude defending City employees. *Sinclair v. Arnebergh*, 224 Cal. App. 2d 595 (1964).

As mentioned earlier, the Tort Claims Act provides for several exceptions to the normal duty of the public entity to provide a defense for its employees. Government Code section 995.2 provides that:

(a) A public entity may refuse to provide for the defense of a civil action or proceeding brought against an employee or former employee if the public entity determines any of the following: (1) The act or omission was not within the scope of his or her employment. (2) He or she acted or failed to act because of actual fraud, corruption or actual malice. (3) The defense of the action or proceeding by the public entity would create a specific conflict of interest between the public entity and the employee or former employee. For the purposes of this section, 'specific conflict of interest' means a conflict of interest or an adverse or pecuniary interest,

as specified by statute or by a rule or regulation of the public entity.

Despite these exceptions, however, the public entity, while not required, is still authorized to furnish the employee's defense if it deems advisable to do so. The discretionary language used to express these limitations does not require the public entity to refuse a requested defense if it chooses to so defend.

Finally, the Tort Claims Act imposes upon public entities a general duty to indemnify their employees for nonpunative damages for tort liability. In actions against their employees for injuries caused by official acts or omissions, public entities must pay any judgment for compensatory damages based thereon or any compromise or settlement of the claim or action to which the public entity has agreed if:

- (a) the employee or former employee made a written request not less than 10 days before trial for the public entity to defend him in the action,
- (b) the public entity conducted the employee's defense, and
- (c) the employee reasonably cooperated in good faith in the defense of the action.

Government Code section 825.

The principal purpose of the indemnification provisions is to protect public employees against personal financial losses arising from the performance of their official duties, and thus prevent discouragement from diligent performance of those duties. Van Alstyne, California Government Tort Liability Practice sections 5.82 et seq. (CEB 1990).

Please be advised, however, that an indemnification clause will not be construed to protect a trustee against his or her own wrongful acts in violation of the trust so as to practically relieve the trustee from every duty which would otherwise be imposed by the creation of the trust. As suggested earlier,

Under general trust principles, a violation by a trustee, whether fraudulent or through negligence, or arising through mere oversight or forgetfulness is a breach of trust, and the trustee may be charged with the rents, profits and income which he never in fact received, but which he might and should have received by the exercise of due and reasonable care and diligence.

(Citations omitted.)

71 Op. Att'y Gen. 129, 138 (1988).

In short, the protections afforded by the Government Code outlined above apply only when the public employee is acting within the course and scope of his or her duties and responsibilities.

#### CONCLUSION

All Board members are by definition "unclassified employees" of the

City of San Diego. As such, they are entitled to all of the protections and indemnification provisions set forth in the Government Code as long as they are acting in their capacity as a Board member and exercising their duties and responsibilities under the Charter and the SDMC. The insurance policy purchased by the City provides additional coverage.

In closing, we note that any decision by CERS to purchase yet additional insurance for its fiduciaries or for itself to cover liability or losses occurring by reason of the act or omission of a fiduciary is a policy decision to be handled accordingly. We do advise, however, that any insurance purchased for these purposes receive strict scrutiny. Typically, this type of insurance coverage is satisfactory only if the insurance permits recourse by the insurer against the fiduciary in the case of a breach of a fiduciary obligation by the fiduciary.

JOHN W. WITT, City Attorney

By

Loraine L. Etherington

Deputy City Attorney

LLE:mrh:352(x043.2)

ML-91-90